

REPORT OF EXAMINATION  
OF THE  
CALIFORNIA STATE AUTOMOBILE ASSOCIATION  
INTER-INSURANCE BUREAU  
  
AS OF  
DECEMBER 31, 2004

Participating State  
and Zone:

California

Filed May 30, 2006

## TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION.....	1
SUBSEQUENT EVENTS .....	2
MANAGEMENT AND CONTROL: .....	3
Management Agreements .....	6
CORPORATE RECORDS .....	9
TERRITORY AND PLAN OF OPERATION .....	9
REINSURANCE: .....	10
Reinsurance Pooling Agreement .....	10
Assumed.....	11
Ceded .....	11
ACCOUNTS AND RECORDS:.....	12
Information System Controls .....	12
Premiums and Agents' Balances in the Course of Collection .....	12
Annual Statement Disclosures .....	12
FINANCIAL STATEMENTS:.....	13
Statement of Financial Condition as of December 31, 2004 .....	14
Underwriting and Investment Exhibit for the Year Ended December 31, 2004.....	15
Reconciliation of Surplus as Regards Policyholders from December 31, 2001 through December 31, 2004 .....	16
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	17
Losses and Loss Adjustment Expenses .....	17
SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....	17
Current Report of Examination.....	17
Previous Report of Examination .....	18
ACKNOWLEDGEMENT .....	20

San Francisco, California  
May, 17, 2006

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition (EX4) Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Gary L. Smith  
Secretary, Zone IV-Western  
Director of Insurance  
Department of Insurance, State of Idaho  
Boise, Idaho

Honorable John Garamendi  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Chairman, Director and Commissioner:

Pursuant to your instructions, an examination was made of the

**CALIFORNIA STATE AUTOMOBILE ASSOCIATION INTER-INSURANCE BUREAU**

(hereinafter also referred to as the Bureau) at its home office located at 100 Van Ness Avenue, San Francisco, California 94102.

**SCOPE OF EXAMINATION**

The previous examination of the Bureau was made as of December 31, 2001. This examination covers the period from January 1, 2002 through December 31, 2004. The examination was conducted pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Bureau's practices and procedures, an examination of management records, tests and analyses of detailed transactions, and an evaluation of assets and a determination of liabilities as of December 31, 2004, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Bureau's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of Bureau; business in force by states; loss experience; and sales and advertising.

### SUBSEQUENT EVENTS

In 2005, the Bureau became part of an "enterprise-wide" reorganization plan which included: The California State Automobile Association (CSAA), a motor club affiliated with the Bureau; AAA Arizona, Inc., a motor club operating in the state of Arizona; AAA MountainWest, Inc., a motor club operating in the states of Alaska, Montana, and Wyoming; and ACA Holdings, Inc. (ACA), a newly formed California mutual benefit corporation and the ultimate controlling entity. One effect of the plan on the Bureau was to allow the Bureau to expand its insurance sales into the territories of other motor clubs which are members of the American Automobile Association (AAA) through affiliations with those motor clubs. In 2005, the Bureau became a party to two Reorganization Agreements in which the other parties were ACA, CSAA, AAA Mountain West, Inc., and AAA Arizona, Inc. The Reorganization Agreements provided that each of their motor clubs, including CSAA, would issue to ACA corporate memberships in the respective clubs. As a corporate member, ACA is granted the power to approve, among other things, the motor clubs' strategic plans and operating budgets, material changes in their capital structures, material transactions involving the motor clubs, and nominations by each motor club to the ACA board. A majority of the ACA board consisted of board members of CSAA, with a minority of seats allocated to AAA Arizona, Inc. and AAA MountainWest, Inc.

At the same time as the reorganization, the Bureau entered into a Development Agreement with AAA Arizona, Inc. This agreement provided for expenditures by the Bureau to expand AAA Arizona, Inc.'s insurance business and to transfer a portion of AAA Arizona Inc.'s existing book of business to the Bureau's insurance subsidiaries, Western United Insurance Company and ACA Insurance Company.

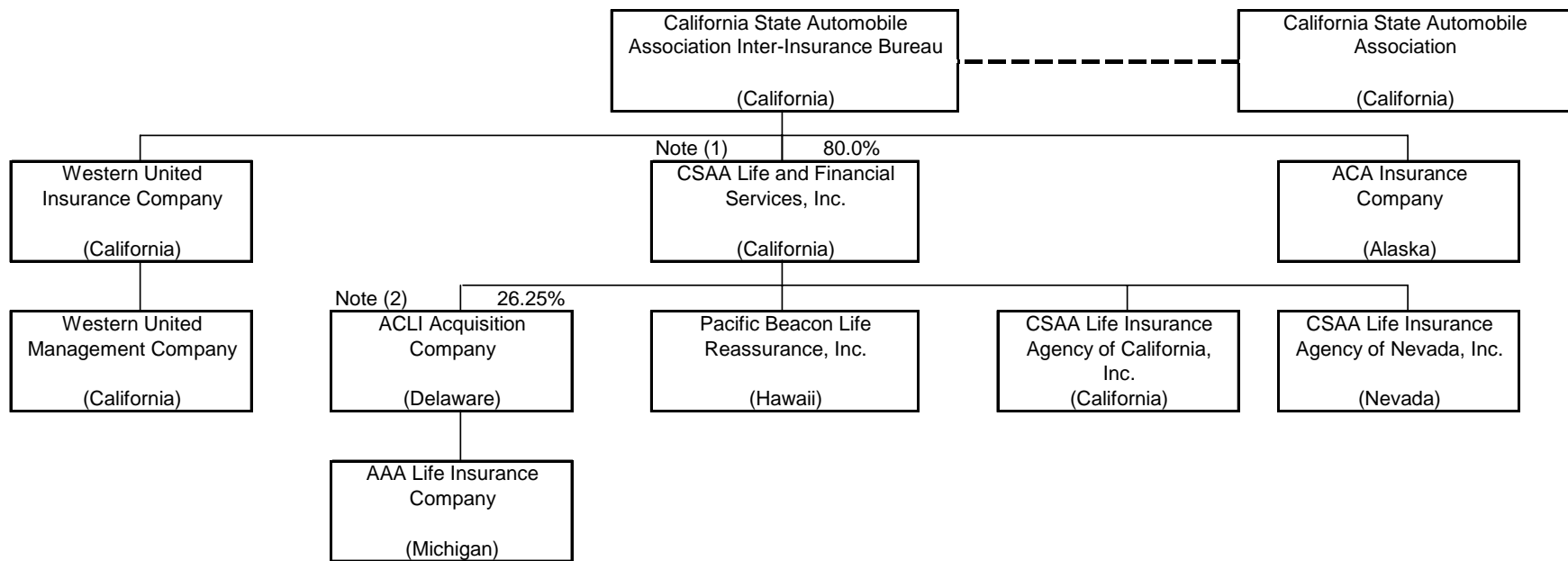
Corporate filings were made with the California Department of Insurance (CDI) in July 2004 and March 2005 in regards to the reorganization. One filing involved a change in control of the Bureau by granting to ACA the power to elect the Bureau's Insurance Board. The Bureau informed the examiners that it plans to withdraw this filing. The other filings involved the proposed formation of a new stock company which would serve as the Bureau's attorney-in-fact, and would provide management and agency services for the Bureau, as well as other affiliates. The remaining filings are pending CDI approval.

### BUREAU HISTORY

The Bureau is a reciprocal insurer organized under the laws of California on June 20, 1914. The Bureau was created to offer automobile insurance to members of the California State Automobile Association, a motor club incorporated in 1907.

### MANAGEMENT AND CONTROL

The Bureau is part of an insurance holding company system, which includes the California State Automobile Association (CSAA) as well as other insurers, agencies and holding companies. The Bureau's Insurance Board is comprised of directors elected by the board of directors of CSAA and three ex officio directors, who are officers of the Bureau. CSAA and the Bureau had been operating under a disclaimer of affiliation granted to it by the California Department of Insurance (CDI) under California Insurance Code Section 1215.4(l) in 1974. The disclaimer has exempted the Bureau from registering and reporting transactions with CSAA under the Insurance Holding Company System Regulatory Act. The disclaimer was disallowed by the CDI effective April 11, 2006. The following chart depicts the Bureau with subsidiaries and affiliates at December 31, 2004. Each company is 100% owned except as otherwise indicated:



Note (1) - Remainder of ownership by California State Automobile Association.

Note (2) - Remainder of ownership by the following entities:

Auto Club Life Insurance Company (Michigan)	- 26.250%
Automobile Club of Southern California (California)	- 13.125%
Interinsurance Exchange of the Automobile Club (California)	- 13.125%
The American Automobile Association, Inc. (Connecticut)	- 20.400%
Other AAA Clubs and Their Affiliates	- 00.850%
<b>Total</b>	<b>- 73.750%</b>

----- Common Directors.

Management of the Bureau is vested in a twenty-one member Insurance Board. A listing of the members of the board and principal officers serving on December 31, 2004 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Paula R. Collins, Chair San Francisco, California	Chief Executive Officer WDG Ventures, Inc.
Robert N. Barone Reno, Nevada	Chairman Adagio Trust Company
Edgar H. Grubb Walnut Creek, California	Retired
Norma J. Howard Novato, California	President NOHOW Communications
Sylvester Lucena Chico, California	President Collier Hardware
Dr. Alistair W. McCrone Arcata, California	President Emeritus Humboldt State University
Wayne R. Moon San Francisco, California	Chairman of the Board RelayHealth, Inc.
A. Kenneth Nilsson Carmel, California	Consultant
Wendy Paskin-Jordan San Francisco, California	Managing Partner Paskin & Kahr Capital Management, LLC
Lawrence R. Pentis * San Rafael, California	Senior Vice President, Insurance Product Management California State Automobile Association
James R. Pouliot * Diablo, California	President and CEO California State Automobile Association
Estelle G. Saltzman Sacramento, California	Principal and President Runyon, Saltzman & Einhorn, Inc.

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
William A. Smith * Laguna Nigel, California	Chief Financial Officer California State Automobile Association
Leo Soong Walnut Creek, California	President Trinity Products, LLC
Vivian M. Stephenson San Francisco, California	Chief Operations Officer Williams-Sonoma, Inc.
Ivan L. Suess Lodi, California	Owner Schaffer, Suess & Boyd Realtors
Stephen H. Wainwright Merced, California	President Stephen H. Wainwright, Inc.
Shirley A. Ward Sebastopol, California	Retired
Daniel K. Whitehurst Fresno, California	President Farewell, Inc.
Robert E. Wilcox Alpine, Utah	Consulting Actuary R.E. Wilcox & Company
Kline A. Wilson, Jr. Oakland, California	Operations Manager Fouche's Hudson Funeral Home

\* Ex Officio directors with voting power.

#### Principal Officers

<u>Name</u>	<u>Title</u>
James R. Pouliot #	President, Chief Executive Officer
William A. Smith #	Chief Financial Officer
Lawrence R. Pentis #	Senior Vice President, Insurance Operations
Eileen F. Braunreiter	Secretary

# Substitute Attorneys-in-Fact appointed by elected members of the Executive Committee of the Insurance Board. Said elected members constitute the true Attorney-in-Fact.

#### Management Agreements



Restated Intercompany Services Agreement: Under this agreement, the Bureau provided a wide range of services to its subsidiaries, including accounting, underwriting, claims, investment, personnel and other functional support services. Services were provided at cost. Subsidiaries which were party to this agreement were: ACA Insurance Company, CSAA Life and Financial Services, Inc., CSAA Life Insurance Agency of California, Inc., CSAA Life Insurance Agency of Nevada, Inc., Pacific Beacon Life Reassurance, Inc., Western United Insurance Company, and Western United Management Company, all of which were owned at least eighty percent by the Bureau. This agreement superseded the Services and Investment Management Agreements in effect during the last examination, and was approved by the CDI for use on August 1, 2005.

Claims Administration Services Agreement: Parties to the agreement included the Bureau and ACA Insurance Company (ACA). The purpose of the agreement was for the Bureau to provide claims services for homeowners policies written by ACA in states other than Alaska, its domiciliary state. The agreement was approved as part of ACA's certificate of authority application for admission to California. ACA was admitted on April 6, 2005.

Restated Claims Administration Services Agreement: Parties to the agreement were the Bureau and Western United Insurance Company (WUIC). The purpose of the agreement was for the Bureau to provide claims services to WUIC for homeowner policies written by WUIC. This agreement was approved by the CDI on March 22, 2004.

Restated Intercompany Tax Allocation Agreement: Parties to the agreement included the Bureau and the seven subsidiaries which were part of the Restated Intercompany Services Agreement previously mentioned. This agreement replaced the Tax Allocation Agreement dated February 26, 1999, and was approved by the CDI on August 1, 2005. The agreement allocates federal income taxes among the companies on a separate-company basis.

Development Agreement: This agreement was entered into in February 2005. The signatories are AAA Arizona, Inc. (an auto club and member of the American Automobile Association) and the Bureau. However, the text of the agreement states that the “Bureau” includes its “insurer subsidiaries.” The purpose of the agreement was to provide AAA Arizona, Inc. financial incentives for endorsing the Bureau for its members’ insurance needs. This agreement did not meet the fair and reasonable standards of California Insurance Code (CIC) Section 1215.5, because it does not make clear the amount or extent of the individual obligations of the Bureau and its insurance subsidiaries. It is recommended the Bureau revise the agreement to specify which insurer subsidiaries are party to the agreement, and what their individual obligations are.

Amended and Restated Insurance Agency Agreement: This agreement was between the Bureau and the California State Automobile Association (Association) for the purpose of appointing the Association as the exclusive agent for the Bureau’s production of business, setting commission rates, and responsibilities of each party. This agreement did not require approval by the CDI due to a disclaimer of affiliation in effect at the time. Disclosure was made in the audited financial statements indicating that the Bureau paid the Association fixed and variable sales commissions of \$187.4 million and \$24.5 million in 2004, respectively.

Brand Fee Agreement: Under this agreement, the Bureau paid the Association a fee equal to one percent of direct premium written for the use of trademarks owned or licensed to the Association which were used by the Bureau to promote its insurance products. The Bureau paid \$19.7 million to the Association in 2004 under this agreement. This agreement did not require approval by the CDI due to a disclaimer of affiliation in effect at the time.

Amended Members Personal Accident Insurance Agreement: This agreement, between the Bureau and Association, allowed the Bureau to underwrite personal accident insurance for members of the Association. The program was put in run-off in October 2004, and should be fully run-off by October 2005.

Service Agreement(s): There were two separate agreements covering the provision of services between the Bureau and the Association. In one agreement, the Association provided services to the

Bureau, which included operation and management of district offices, and related administrative services. The Bureau paid the Association \$24.8 million in 2004 for these services. In the second agreement, the Bureau provided the following services to the Association: accounting, programming, data processing, real estate development, personnel management, and other related administrative and consultation services. The Association paid the Bureau \$298.1 million in 2004 for these services. All services were provided at cost. This agreement did not require approval by the CDI due to a disclaimer of affiliation in effect at the time.

### CORPORATE RECORDS

California Insurance Code (CIC) Section 735 states that the Bureau must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the commissioner. The board must also enter that fact in the board minutes. A review of the board minutes disclosed no record of the board members being presented with the financial examination report as of December 31, 2001.

The Bureau's board actions regarding the authorization and approval of investments did not satisfy the requirements of CIC Section 1201. The Bureau's board minutes failed to document specific references to amounts, facts and the values of the securities as required under CIC Section 1201.

It is recommended that the Bureau implement procedures to ensure future compliance with CIC Sections 735 and 1201.

### TERRITORY AND PLAN OF OPERATION

As of December 31, 2004, the Bureau was licensed as a multi-line property and casualty insurer in the states of California, Nevada, Utah, and Wyoming. Direct premiums written in 2004 were \$1.9 billion (96%) in California and \$74.5 million (4%) in Nevada. Major lines of business included private passenger auto liability (45%), auto physical damage (37%) and homeowners' multiple peril (17%). A small amount of earthquake was written for risks located in Nevada. All California

earthquake coverage was written by the California Earthquake Authority, therefore all premiums and losses from these policies were not recorded on the Bureau's books. The Bureau added umbrella liability in 2003 for insureds that have both auto and homeowners policies with the Bureau. Limits of liability were written up to \$5 million. Some accident and health insurance was written as travel accident coverage for members of the California State Automobile Association (Association), but this is now in run-off. The Bureau acquires its business through approximately 590 exclusive agents of the Association. The Association is a member of the American Automobile Association (AAA), and as such, is assigned the territory of northern California, Nevada and Utah. As the Bureau exclusively writes for members of the Association, the Bureau has been restricted to these areas as well.

The Bureau has two wholly-owned insurance subsidiaries, Western United Insurance Company (WUIC) domiciled in California and ACA Insurance Company (ACA) domiciled in Alaska. During the examination period, WUIC and ACA became licensed in many new states. The Bureau plans to use the newly licensed territories of WUIC and ACA as a platform for its own expansion, either through reinsurance or by forming new alliances with other AAA motor clubs.

## REINSURANCE

### Reinsurance Pooling Agreement

The Bureau participates in a pooling agreement with its subsidiary, Western United Insurance Company (WUIC). WUIC writes non-standard auto, mostly in California. All premiums, losses and expenses are pooled, with the Bureau's participation set at 98.87% and WUIC at 1.13%. All business written by the pool participants is subject to the Reinsurance Pooling Agreement.

### Assumed

The Bureau assumed reinsurance from its other wholly-owned subsidiary, ACA Insurance Company (ACA), under a 90% quota share agreement. ACA writes homeowners insurance in the states of Nevada and Arizona.

### Ceded

The Bureau's ceded reinsurance program consisted mainly of catastrophe coverage of \$500 million in excess of the Bureau's retention of \$75 million. The Bureau also had brushfire catastrophe coverage of \$50 million in excess of \$25 million. Other than amounts ceded under the Reinsurance Pooling Agreement to Western United Insurance Company and minor amounts to the National Flood Insurance Program, the Bureau had no ceded losses at December 31, 2004. The following is a summary of the principal ceded reinsurance treaties inforce as of December 31, 2004:

Type of Contract and Lines of Business	Reinsurer(s)	Limits
Catastrophe Excess of Loss Covers catastrophic property loss on homeowners multiple peril (property sections), auto physical damage, earthquake, fire and inland marine.	Various authorized and unauthorized reinsurers and percentages apply.	<u>1<sup>st</sup> Layer:</u> \$75 million excess of \$75 million per occurrence
		<u>2<sup>nd</sup> Layer:</u> \$100 million excess of \$150 million per occurrence
		<u>3<sup>rd</sup> Layer:</u> \$100 million excess of \$250 million per occurrence
		<u>4<sup>th</sup> Layer:</u> \$100 million excess of \$350 million per occurrence
		<u>5<sup>th</sup> Layer:</u> \$50 million excess of \$450 million per occurrence
Catastrophe Excess of Loss - Brushfire Covers catastrophic loss by fire on homeowners multiple peril (property sections), auto physical damage, fire and inland marine. Fire following an earthquake is specifically excluded.	Various authorized and unauthorized reinsurers and percentages apply.	\$25 million excess of \$50 million per occurrence
Excess of Loss - Property Facultative Covers homeowners multiple peril (property sections).	General Reinsurance Corporation	\$5.5 million excess of \$1.5 million per risk, subject to a maximum of \$27.5 million on all risks per occurrence

## ACCOUNTS AND RECORDS

### Information System Controls

During the course of the examination, a review was made of the Bureau's general controls over its information systems. As the result of this review, weaknesses were noted in the areas of user access administration, information security, program change controls, and physical controls. The weaknesses noted were presented to the Bureau along with recommendations to strengthen its controls. The Bureau should evaluate the recommendations and make appropriate changes to strengthen its information system controls.

### Premiums and Agents' Balances in the Course of Collection

The Bureau's premium system does not provide policy level detail for aging of uncollected premiums, nor does it segregate installments booked but deferred and not yet due from premiums in the course of collection. The Bureau is aware of this and plans to implement a new premium billing and collection system mid-2006. The Bureau has stated that the new system will be capable of correcting these deficiencies.

### Annual Statement Disclosures

In a number of instances, the Bureau failed to provide adequate disclosure in its 2004 Annual Statement, Notes to the Financial Statements as required by the Annual Statement Instructions or by Statutory Accounting Principles. These items were discussed with the Bureau.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2004

Underwriting and Investment Exhibit for the Year Ended December 31, 2004

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2001 through December 31, 2004

Statement of Financial Condition  
as of December 31, 2004

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 2,153,290,750	\$	\$ 2,153,290,750	
Preferred stocks	31,253,823		31,253,823	
Common stocks	1,191,829,436		1,191,829,436	
Properties occupied by the company	129,089,378		129,089,378	
Cash, cash equivalents and short-term investments	228,027,839		228,027,839	
Other invested assets	2,939,369		2,939,369	
Receivable for securities	17,957,612		17,957,612	
Aggregate write-ins for invested assets	161,799,413		161,799,413	
Investment income due and accrued	26,899,916		26,899,916	
Uncollected premiums and agents' balances in the course of collection	657,811,820	1,871,920	655,939,900	
Amounts recoverable from reinsurers	489,150		489,150	
Other amounts receivable under reinsurance contracts	484,453		484,453	
Current federal and foreign income tax recoverable	3,876,865		3,876,865	
Net deferred tax asset	63,678,466		63,678,466	
Electronic data processing equipment and software	115,563,961	114,745,437	818,524	
Furniture and equipment	35,994,907	35,994,907		
Receivables from parent, subsidiaries and affiliates	235,758		235,758	
Other assets nonadmitted	3,339,463	3,339,463		
Aggregate write-ins for other than invested assets	<u>127,233,652</u>	<u>68,020,054</u>	<u>59,213,598</u>	
Total assets	<u>\$ 4,951,796,031</u>	<u>\$ 223,971,781</u>	<u>\$ 4,727,824,250</u>	

Liabilities, Surplus and Other Funds

Losses		\$ 634,749,922	(1)
Reinsurance payable on paid loss and loss adjustment expenses		554,442	
Loss adjustment expenses		166,251,471	(1)
Commissions payable, contingent commissions and other similar charges		1,552,499	
Other expenses (excluding taxes, licenses and fees)		224,782,269	
Taxes, licenses and fees (excluding federal and foreign income taxes)		5,245,054	
Current federal and foreign income taxes		23,630,618	
Unearned premiums		1,046,925,032	
Advance premiums		6,006,254	
Dividends declared and unpaid: policyholders		7,483,725	
Ceded reinsurance premiums payable		1,819,156	
Amounts withheld or retained by company for account of others		904,759	
Remittances and items not allocated		4,408,374	
Drafts outstanding		534,308	
Payable to parent, subsidiaries and affiliates		368,137	
Payable for securities		14,937,934	
Aggregate write-ins for liabilities		<u>183,455,933</u>	
Total liabilities		2,323,609,887	
Aggregate write-ins for special surplus funds	\$ 339,207,615		
Unassigned funds (surplus)	<u>2,065,006,748</u>		
Surplus as regards policyholders		<u>2,404,214,363</u>	
Total liabilities, surplus and other funds		<u>\$ 4,727,824,250</u>	



Underwriting and Investment Exhibit  
for the Year Ended December 31, 2004

Statement of Income

Underwriting Income

Premiums earned		\$ 2,043,964,096
Deductions:		
Losses incurred	\$ 1,079,622,195	
Loss expenses incurred	293,943,471	
Other underwriting expenses incurred	<u>503,556,723</u>	
Total underwriting deductions		<u>1,877,122,389</u>
Net underwriting gain		166,841,707

Investment Income

Net investment income earned	\$ 116,286,499	
Net realized capital losses	<u>(802,946)</u>	
Net investment gain		115,483,553

Other Income

Net loss from agents' balances charged off	\$ (7,131,946)	
Finance and service charges not included in premiums	2,930,888	
Aggregate write-ins for miscellaneous income	<u>53,932,837</u>	
Total other income		<u>49,731,779</u>
Net income before dividends to policyholders and before federal income taxes		332,057,039
Dividends to policyholders		30,603,998
Federal income taxes incurred		<u>52,235,899</u>
Net income		\$ <u>249,217,142</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		\$ 2,126,667,081
Net income	\$ 249,217,142	
Change in net unrealized capital gains	167,759,129	
Change in net deferred income tax	(87,864,887)	
Change in nonadmitted assets	(51,623,262)	
Aggregate write-ins for gains and losses in surplus	<u>59,160</u>	
Change in surplus as regards policyholders for the year		<u>277,547,282</u>
Surplus as regards policyholders, December 31, 2004		\$ <u>2,404,214,363</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2001 through December 31, 2004

Surplus as regards policyholders, December 31, 2001, per Examination			\$ 1,865,781,486
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 442,492,157	\$	
Change in net unrealized capital gains or losses	240,401,079		
Change in net deferred income tax		137,720,921	
Change in nonadmitted assets	1,168,478		
Aggregate write-ins for gains in surplus	<u>                    </u>	<u>7,907,916</u>	
Total gains and losses	\$ <u>684,061,714</u>	\$ <u>145,628,837</u>	
Net increase in surplus as regards policyholders			<u>538,432,877</u>
Surplus as regards policyholders, December 31, 2004, per Examination			\$ <u>2,404,214,363</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### Losses and Loss Adjustment Expenses

The California Department of Insurance (CDI) retained an independent consulting actuary to perform an analysis of the Bureau's loss and loss adjustment expense reserves. A Casualty Actuary with the CDI reviewed the analysis and concurred with the conclusion that the reserves were determined to be reasonable.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control – Management Agreements (Page 7): It is recommended the Bureau revise its Development Agreement with AAA Arizona, Inc. to specify which insurer subsidiaries are party to the agreement and what their individual obligations are, in order to meet the fair and reasonable standards of California Insurance Code (CIC) Section 1215.5.

Corporate Records (Page 9): It is recommended that the Bureau implement procedures to ensure future compliance with CIC Section 735.

Corporate Records (Page 9): It is recommended that the Bureau implement procedures to ensure future compliance with CIC Section 1201.

Accounts and Records - Information System Controls (Page 12): It is recommended that the Bureau review the recommendations made regarding its information systems and make appropriate changes to strengthen internal controls.

### Previous Report of Examination

Management and Control – Management Arrangements (Page 6): It was recommended that the Bureau submit its revised Federal Income Tax Allocation Agreement and Services and Investment Management Agreements to the California Department of Insurance (CDI) for approval pursuant to California Insurance Code Section 1215.5(b). These agreements were replaced with the Restated Intercompany Services Agreement and the Restated Intercompany Tax Allocation Agreement, both of which were submitted by the Bureau and subsequently approved for use by the CDI.

Reinsurance – Reinsurance Pooling Agreement (Page 9): It was recommended that the Bureau submit the fully executed Reinsurance Pooling Agreement to the CDI. The fully executed Reinsurance Pooling Agreement was provided to the examiners during the course of the examination.

Reinsurance – Ceded (Page 9): It was recommended that the Bureau's excess catastrophe treaty be amended to contain a reporting provision that required reports of premiums and losses, and payment of losses, no less frequently than on a quarterly basis. The Bureau's reinsurance agreements at the examination date contained this provision.

Accounts and Records – Information Systems Controls (Page 12): It was recommended the Bureau evaluate and make appropriate changes to its information system controls in several key areas. Review of those controls for this examination indicated the Bureau had made appropriate changes, with the exception of documentation of changes to the PAM investment accounting system. The Bureau discontinued use of the PAM system late in 2005 when it outsourced its investment accounting to State Street.

Accounts and Records – Data Validation (Page 12): It was recommended that the Bureau implement controls in the premium billing system to ensure the accuracy and validity of premiums receivable. It was also recommended that the Bureau implement controls over the online claims systems to ensure that salvage and subrogation recoveries were properly recorded. The Bureau stated that it will be adopting a new premium system mid-2006 which will have the necessary controls to ensure

the accuracy and validity of premiums receivable. No instances of improperly coded salvage or subrogation recoveries were noted during the data testing for this examination.

Comments on Financial Statement Items – Premiums and Agents’ Balances in the Course of Collection (Page 16): It was recommended that the Bureau implement procedures to ensure that a policy by policy aging detail is available. Such detail was not available during this examination as well. The Bureau stated that it will be adopting a new premium system mid-2006 which will include policy level detail.

Comments on Financial Statement Items – Other Expenses (Page 16): It was recommended the Bureau report net periodic income from its pension plan in accordance with Statement of Statutory Accounting Principles No. 8. The Bureau was found to be in compliance.

Comments on Financial Statement Items – Taxes, Licenses and Fees (Page 16): It was recommended that the Bureau non-admit prepaid expenses included in this account. It was noted during this examination that the Bureau records payments of sales and use tax in a separate account for internal purposes. This account is part of a group of accounts, that when viewed together was not prepaid.

Comments on Financial Statement Items – Amounts Withheld or Retained by Bureau for Account of Others (Page 17): It was recommended that the Bureau implement controls to ensure that these accounts are reconciled and cleared in a timely manner. It was also recommended that the Bureau report suspense items and unclaimed credits on the appropriate Annual Statement lines. The Bureau was found to be in compliance.

## ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Bureau's officers and employees during the course of this examination is gratefully acknowledged.

Respectfully submitted,

---

Isabel Spiker, CFE  
Examiner-In-Charge  
Senior Insurance Examiner  
Department of Insurance  
State of California